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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. ~~102~~ 3

THE EXCHANGE AND SAVINGS BANK OF BERLIN,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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INDEX

Table of Contents

	PAGE
Citations To Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statute and Regulation Involved	3
Statement of the Case	4
Reasons For Granting the Writ	11
Conclusion	18
Appendix A—Opinions and Judgments Below	1a
Appendix B—The Bank of Leipsic Company v. United States of America (U.S. District Court, Northern District of Ohio, Western Division, Civil Action No. 7871, 11/4/58):	
Findings of Fact and Conclusion of Law	18a
Oral Opinion	26a
United States v. Bank of Leipsic Co. (6 Cir., 1959):	
Opinion	35a

Table of Citations

Cases

Farmers & Merchants Bank v. Commissioner, 175 F. 2d 846 (8 Cir., 1949)	14, 17
United States v. Bank of Leipsic Co., 272 F. 2d 341 (6 Cir., 1959)	8, 11, 12, 13, 14

Statutes

	PAGE
Internal Revenue Code of 1939:	
Title 26 U.S.C., Section 3798(b)	12
Internal Revenue Code of 1954:	
Title 26 U.S.C., Section 7507(b)	4, 6, 7, 8, 9, 11, 12, 15, 17

Treasury Regulations

Section 301.7507-2(a) (26 C.F.R. Section 301.7507-2(a))	17

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, filed in the above-entitled case on September 6, 1966.

CITATIONS TO OPINIONS BELOW

The Opinions of the United States District Court for the District of Maryland, entered June 4, 1965 and filed June 7, 1965, is reported at 242 F. Supp. 838. The Opinion of the United States Court of Appeals for the Fourth Circuit, entered and filed September 6, 1966, is reported at 368 F. 2d 334. Both Opinions are printed in Appendix A hereto.

JURISDICTION

The Judgment of the United States Court of Appeals for the Fourth Circuit was entered and filed on September 6, 1966 (Appx. A, p. 17a, *infra*). Its Order denying a Petition for Rehearing was filed on November 3, 1966. The jurisdiction of this Court to review the Judgment of the United States Court of Appeals for the Fourth Circuit is conferred by 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

Subsection (b) of Section 7507 of the Internal Revenue Code of 1954 (26 U.S.C. Section 7507(b)) provides in part that when a bank has been released from its liability to its depositors for any part of their claims and the depositors have accepted a lien upon subsequent earnings of the bank in lieu of such liability, no tax shall be assessed or collected or paid into the Treasury of the United States on account of such bank which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof.

The questions presented are:

1. Did the assessment, collection and payment of Federal income taxes for 1957, 1958 and 1959 diminish the assets of Petitioner which were available for the payment of depositor claims and necessary for the full payment thereof within the meaning of Section 7507(b) of the Internal Revenue Code of 1954, where (a) the Bank Commissioner of Maryland, which had jurisdiction over the operation of Petitioner as a bank, determined that the payment in 1957 of any amount at all on depositor claims and the payment in 1958 and 1959 of any amounts on depositor claims in excess of limited amounts approved by the Bank Commissioner would have jeopardized the safety of the current

depositors of Petitioner and eventual full repayment of the depositor claims, (b) in determining the amount permitted to be paid in 1958 on depositor claims, the Bank Commissioner relied on Petitioner being exempt from Federal income taxes, and (c) if Federal income taxes had not been paid for 1958 and 1959, the Bank Commissioner would have increased the amounts allowed to be paid in those years on depositor claims by at least the amount of such taxes?

2. Were the determinations of the Bank Commissioner of Maryland as to the amounts which could be paid on depositor claims and as to the assets required to be retained undiminished in order not to jeopardize the safety of current depositors and eventual full repayment of the depositor claims binding for the purpose of determining the assets of Petitioner which were available for the payment of the depositor claims and necessary for the full payment thereof within the meaning of Subsection 7507(b) of the Internal Revenue Code of 1954 and not subject to revision unless such determinations were arbitrary or not made in good faith?

STATUTE AND REGULATION INVOLVED

The statute involved is Subsection (b) of Section 7507 of the Internal Revenue Code of 1954, 68A Stat. 897, 26 U.S.C. Section 7507, which subsection reads as follows:

> "(b) Segregated assets; earnings. — Whenever any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has been released or discharged from its liability to its depositors for any part of their claims against it, and such depositors have accepted, in lieu thereof, a lien upon subsequent earnings of such bank or trust company, or claims against assets segregated by such bank or trust company or

against assets transferred from it to an individual or corporate trustee or agent, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank or trust company, such individual or corporate trustee or such agent, which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof. The term 'agent', as used in this subsection, shall be deemed to include a corporation acting as a liquidating agent."

The Treasury Regulation deemed pertinent is Reg. Section 301.7507-2(a) (26 C.F.R., Section 301.7507-2(a)) which reads as follows:

"Section 301.7507-2. *Scope of section generally* — (a) *Purpose.* Section 7507 is intended to assist depositors of a bank which had ceased to do business by reason of insolvency to recover their deposits, by prohibiting collection of taxes of the bank which would diminish the assets necessary for payment of its depositors and also assist depositors of banks which are in financial difficulties but which, in certain conditions, continue in business."

STATEMENT OF THE CASE

All of the facts were stipulated by the parties in the District Court (R. I-5—I-13).* The sole issue in the case has been whether, in light of such stipulated facts, the assessment, collection and payment of Federal income taxes on account of Petitioners with respect to the years in question diminished the assets thereof which, within the meaning of Section 7507(b) of the Internal Revenue Code of 1954, were "available" for the payment of depositor claims under an Agreement Petitioner entered into with its depositors in 1932 and were "necessary for the full payment thereof".

* As used in this Petition, "R" refers to the appendix record below.

Petitioner, The Exchange and Savings Bank of Berlin (hereinafter referred to as "the Bank"), is and at all material times has been a bank located in Berlin, Maryland, a substantial portion of the business of which has consisted of receiving deposits and making loans and discounts (Stip. Par. 1, 2; R. I-5). After its affairs had been placed in the hands of a receiver in February, 1932, the Bank, on March 19, 1932, entered into an Agreement with its depositors (hereinafter referred to as "the Agreement" and the essential terms of which are set forth in footnote 2 to the Opinion of the District Court, Appx. A, p. 2a, *infra*), by the terms of which the Bank was released from its immediate liability to such depositors to the extent of Fifty Percent (50%) of their then deposits for the stated purpose of creating an immediate reserve to protect and maintain the solvency of the Bank and to replace past and future losses. The Agreement further provided that in the event at any time in the future the financial condition of the Bank should warrant the repayment of such reserve in whole or in part and provided the Bank Commissioner of the State of Maryland shall have first given his consent, then the depositors were to be repaid proportionately and at a specified rate of interest. In the meantime, it was provided that no dividends were to be paid upon the capital stock of the Bank until the waived deposits had been repaid in full, and that in the event of a merger or liquidation of the Bank, the then unpaid balance of such waived deposits was to be preferred over capital stock in any distribution of the Bank's assets. It is clear that no fund was set aside nor specific assets segregated to provide for repayment of the waived claims. The parties have stipulated that under such terms of the Agreement, the depositors so releasing the Bank from liability for a part of their claims against it accepted in lieu thereof "a lien upon subsequent earnings" of the Bank within the meaning of

Section 7507(b) of the Internal Revenue Code of 1954 (Stip. Par. 6; R. I-6).

Since 1933, the Bank has been a member of the Federal Deposit Insurance Corporation (hereinafter referred to as "the F.D.I.C."), and that agency has participated with the Bank Commissioner of Maryland (hereinafter referred to as "the Bank Commissioner") in annual examinations of the Bank's financial condition. The Bank Commissioner continually consulted with the F.D.I.C. before passing upon requests by the Bank for permission to make payments against the unpaid balances of deposits released under the Agreement (Stip. Par. 7; R. I-6).

The original balance of released deposits in 1932 was $258,736.03 (Stip. Par. 6; R. I-6). By December 31, 1956, such balance had been reduced to $91,878.59 (Stip. Par. 8; R. I-7). During the years 1957 through 1960, the Bank was diligent in its efforts to pay the claims of its depositors under the Agreement as rapidly as would be permitted by the Bank Commissioner (Stip. Par. 22; R. I-11).

In 1957, the Bank requested permission of the Bank Commissioner to repay 5% of the original balance of released deposits but the Commissioner declined and refused to allow any payment at all to be made during 1957 because, in his opinion, after consultation with representatives of the F.D.I.C., the financial condition of the Bank was such that any payment would have jeopardized the safety of its current depositors as well as the eventual full repayment of the unpaid claims of depositors under the Agreement (Stip. Par. 9; R. I-7).

In 1958, request was made for permission to repay 10% of the original balance of released deposits, which permission was granted, predicated, however, upon specific steps being taken by the Bank to improve the condition of its

loan portfolio (Stip. Par. 11; R. I-7, 8). In granting such permission, the Bank Commissioner relied upon the Bank being exempt from Federal income tax liability with respect to 1957 (Stip. Par. 26; R. I-12). Furthermore, he was of the opinion, after consultation with representatives of the F.D.I.C., that the payment of any greater amount during 1958 to participants under the Agreement would have jeopardized the safety of the Bank's current depositors as well as the eventual full repayment of the unpaid claims of depositors under the Agreement (Stip. Par. 11; R. I-7-8).

Requests were likewise made by the Bank in 1959 and 1960 for permission to make 10% payments, which permission was granted and payment made. The Bank Commissioner was of the opinion, after consultation with representatives of the F.D.I.C., that to have permitted payment of a greater amount in either year would have jeopardized the safety of the Bank's current depositors as well as the eventual full repayment of the unpaid claims of depositors under the Agreement (Stip. Par. 13, 15; R. I-8, 9).

Had Federal income taxes not been paid by the Bank with respect to the years 1958, 1959 and 1960, the payments permitted by the Bank Commissioner to be made during those years upon the claims of depositors under the Agreement would have been greater by at least the amount of such taxes (Stip. Par. 27; R. I-12).

The Bank filed with the District Director of Internal Revenue for the District of Maryland its Federal income tax return for the calendar year 1957 reporting net income of $25,284.83 and claiming an exemption and immunity from liability for tax under the provisions of Section 7507(b) of the Internal Revenue Code of 1954. Upon audit, the District Director disallowed the claimed exemption and assessed a deficiency in the amount of $7,648.11 plus interest

in the amount of $1,272.00, the total of which was paid on December 2, 1960 (Stip. Par. 10; R. I-7). The Bank's 1958 return was duly filed, reporting net income of $22,487.60 and a tax liability of $6,741.60, which amount was paid with the filing of the return. To the 1958 return was attached the following statement:

> "As required by Regulation 301.7507-9 The Exchange and Savings Bank notifies the District Director of Internal Revenue that, in its opinion, it has terminated its immunity with respect to earnings under Section 7507 during the taxable year 1958" (Stip. Par. 12; R. I-8).

The Bank's 1958 return was filed on May 1, 1959, some seven (7) months before the United States Court of Appeals for the Sixth Circuit rendered its opinion in *United States v. Bank of Leipsic Co.*, 272 F. 2d 341 (6 Cir., 1959). The Bank's returns for 1959 and 1960 were duly filed, showing net income for each year of $24,056.49 and $24,827.04, respectively, and tax in the respective amounts of $7,216.95 and $7,373.81 was duly paid with the filing of each such return (Stip. Par. 14, 16; R. I-9, 10).

On March 6, 1961, the Bank filed Claims for Refund for the full amount of tax and interest paid for 1957 and for the full amount of tax paid for 1958 and 1959, asserting as the basis therefor an exemption from liability for income tax for each of such years under Section 7507(b) of the Internal Revenue Code of 1954. Notices of Disallowance of the same were mailed to the Bank by certified mail on July 5, 1961. On June 25, 1963, the Bank filed its Bill of Complaint in the United States District Court for the District of Maryland, seeking a refund of income taxes and interest paid for the calendar years 1957, 1958 and 1959. On March 13, 1964, it filed a Claim for Refund for the full amount of income tax paid for 1960, asserting the same basis therefor as for the three previous years. Notice of Disallowance of

the same was not received but after more than six (6) months had expired from the date of filing of the Claim, the Bank amended its Bill of Complaint on November 4, 1964 so as to include therein a Claim for Refund of income taxes paid for 1960. Jurisdiction of the District Court over the issues raised by the Bill of Complaint and Amended Bill of Complaint is conferred by 28 U.S.C. Section 1346(a)(1).

The District Court filed an Opinion on June 7, 1965 wherein it held that the Bank was entitled to exemption from income tax for the years 1957, 1958 and 1959 under Section 7507(b) of the Internal Revenue Code of 1954 but that the exemption should not apply to 1960. With respect to 1960, the Court reasoned that the total of Federal income taxes for the three earlier years, which were paid although not properly assessable, comprised a sum which would have been sufficient to have enabled the Bank in 1960 to have repaid substantially all of its then remaining obligations to its depositors under the Agreement as well as the income tax on the Bank's earnings in 1960 (Appx. A, p. 11a, *infra*). Accordingly, judgment was entered in favor of the Bank on July 23, 1965 for the principal amount of $22,930.10.

The Government appealed to the United States Court of Appeals for the Fourth Circuit pursuant to 28 U.S.C. Section 1291. The Bank did not cross appeal. The Court of Appeals reversed the judgment entered by the District Court.

The Government's position in this case is that when the Bank's total surplus from all earnings sources at the end of any tax year exceeds the balance then due to its depositors under the Agreement, together with the amount of Federal income taxes otherwise due, its statutory immunity

is terminated (Appx. A, p. 5a, *infra*). Applying this contention to the stipulated facts, the Government has based its entire argument on the following: (i) at December 31, 1957, the Bank's balance sheet showed a "Surplus" of $65,000.00 and an additional "Special Reserve Account" on the books (not comprised of an identifiable fund nor segregated assets) of $79,038.88 against a balance of $91,878.59 then due to depositors participating under the Agreement; (ii) at December 31, 1958 the "Surplus" figure was $70,000.00 and the "Special Reserve Account" figure was $76,459.77 against a balance of $66,386.84 then due the depositors; (iii) at December 31, 1959, the "Surplus" was $75,000.00 and the "Special Reserve Account" showed $61,830.30 against a balance of $40,851.39 then due the depositors; and (iv) of the figure designated as "Surplus" on said balance sheets all but $13,500.00 represented net earnings since March 19, 1932 which have been transferred to the Surplus Account from time to time (Stip. Par. 17; R. I-10; and R. II-6-11). (See ALSO Appx. A, p. 3a-4a infra.)

The District Court concluded that Congress could not have intended that balance sheet figures indicating a paper surplus be determinative of whether or not the statutory immunity should apply for "that view neglects the practicalities of the situation" (Appx. A, p. 9a, *infra*). Instead the Court rested its determination of immunity with respect to the years 1957, 1958 and 1959 upon (i) the undisputed good faith determination by the Bank Commissioner that the overall financial condition of the Bank was such that payment under the Agreement of any amount during 1957, or of any greater amounts than were permitted during 1958 and 1959, would have jeopardized not only the safety of current depositors but also the eventual full repayment of the unpaid claims of depositors participating under the Agreement and (ii) the undisputed fact that the

imposition of income tax with respect to such years reduced the payments that otherwise would have been permitted under the Agreement by at least the amount of such taxes (Appx. A, p. 10a, *infra*).

In reversing the judgment of the District Court, the Court of Appeals concluded that Congress did not intend that any qualitative judgment should be exercised in applying Section 7507(b) but rather that the sole test should be whether assets sufficient to pay taxes and the waived claims of depositors are "on hand" (Appx. A, p. 25, *infra*), without regard to whether such assets, or any part thereof, could be actually distributed in payment of the depositor claims under applicable banking practice and procedure and without regard to whether any attempt to distribute such assets, or any part thereof, other than the parts which the Bank Commissioner actually authorized to be distributed, would have jeopardized the eventual full repayment of the unpaid claims of the depositors under the Agreement.

REASONS FOR GRANTING THE WRIT

The decision of the United States Court of Appeals for the Fourth Circuit with respect to the proper construction of Section 7507(b) of the Internal Revenue Code of 1954 and, in particular, with respect to the relevance of and the effect to be given to determinations by the banking authorities having jurisdiction over the bank involved as to the amounts which could be paid on depositor claims and as to the necessity of retaining assets in order not to jeopardize eventual payment in full of depositor claims, is in direct conflict with the decision on the same matters by the United States Court of Appeals for the Sixth Circuit in *United States v. Bank of Leipsic Co.*, 272 F. 2d 341 (6 Cir., 1959), (Appx. B, p. 35a, *infra*).

Both the *Leipsic* case and the instant case involved the interpretation of the same statutory provision.[1] In each case, the issue was whether payment of Federal income taxes for the years in question diminished or would have diminished the bank's assets which were available for the payment of its depositors' claims and were necessary for the full payment thereof. Each case involved a situation in which accumulated earnings were on hand which, according to the bank's balance sheet, would have been sufficient to have repaid the depositors' claims in full and also to have paid the Federal income taxes in dispute. Nevertheless, in each case, the banking authorities having jurisdiction over the operation of the bank involved were of the opinion and determined that payments from the assets of such bank (which, of course, were derived from such accumulated earnings and other sources such as capital and deposits) in excess of the amounts authorized by such banking authorities from time to time would jeopardize the safety of the current depositors of such bank and, of more significance in the instant case, the eventual repayment in full of the depositor claims.

In *Leipsic*, immunity was claimed on all of the returns filed for the years in question and the taxes were not paid until after the depositor claims had been paid in full. The banking authorities testified in *Leipsic* that if such taxes had been assessed and paid currently, the payments which were permitted to be made on the depositor claims would have been correspondingly reduced. Similarly, in the instant case, it was stipulated that in authorizing payments in

[1] Since the *Leipsic* case concerned the years 1952, 1953 and 1954, it involved both Section 7507(b) of the Internal Revenue Code of 1954 and Section 3798(b) of the Internal Revenue Code of 1939. The two sections are identical except for the addition in 1954 of a sentence defining "agent" so as to include a corporation acting as a liquidating agent.

1958, the Bank Commissioner relied upon the Bank being exempt from Federal income taxes for 1957 and it was further stipulated that if Federal income taxes had not been paid with respect to the years 1958, 1959 and 1960, the amounts permitted to be paid by the Bank Commissioner during those years would have been greater by at least the amount of such taxes. Thus, each case involved a factual situation in which the payment of the taxes either would have (in *Leipsic*) or actually did have (in the instant case) the effect of reducing the payments on the depositor claims and of thereby reducing the assets which were actually "available" for the payment of depositor claims.

In *Leipsic*, the District Court for the Northern District of Ohio, Western Division, expressly rejected the "balance sheet" test as not being contemplated by the statute and held that the questions of whether the assessment and payment of the taxes would diminish the assets available for the payment of depositor claims and necessary for the payment in full thereof were to be determined in light of banking practice and, in particular, in light of limitations imposed by the banking authorities on the amounts which could be paid on the depositor claims (Appx. B, *infra*).* This holding of the District Court was affirmed by the Court of Appeals for the Sixth Circuit. Both the decision of the District Court and of the Court of Appeals for the Sixth Circuit necessarily recognized that the determinations by the banking authorities as to the amounts which could be paid out on depositor claims (and thus as to the amount of

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* The District Court's Findings of Fact and Conclusion of Law are not officially reported but are reprinted as Appx. B, pp. 18a through 26a, *infra*. The Opinion of the District Court (Judge Kloeb) was rendered orally and is not officially reported. However, such Opinion is printed at Appx. B, pp. 26a through 39a, *infra*. Such Findings of Fact, Conclusion of Law and Opinion were part of the record in this case before the United States Court of Appeals for the Fourth Circuit (R. II-20-35).

assets required to be retained by the bank), without jeopardizing the solvency of the bank and eventual full repayment of the depositor claims, were relevant to a determination of whether the payment and assessment of taxes would diminish the assets available for the payment of depositor claims and necessary for the full payment thereof, and both Courts held that such determination by relevant banking authorities should be treated as controlling unless they were arbitrary or not made in good faith. These decisions by the District Court and the Court of Appeals for the Sixth Circuit were in entire accord with the statements of the Court of Appeals for the Eighth Circuit in *Farmers & Merchants Bank v. Commissioner*, 175 F. 2d 846 (8 Cir., 1949), in which the Court made repeated references to such earnings in the bank's hands as could "legitimately" and "prudently," under statutory regulation and in accordance with "prudent banking practice", be used for the payment of depositor claims.

On the other hand, in the instant case, the Court of Appeals for the Fourth Circuit expressly held that "the test of 'availability' intended by Congress was whether the assets were on hand without regard to whether the relevant banking authorities were willing to allow such assets to be paid out at that time" (Appx. A, pp. 14a-15a, *infra*). This conclusion by the Court of Appeals for the Fourth Circuit was recognized by it as being in direct conflict with the decision of the Court of Appeals for the Sixth Circuit in *Leipsic* and is clearly equally in conflict with so much of the decision by the Court of Appeals for the Eighth Circuit in *Farmers & Merchants Bank* as held that the immunity was available even though under applicable banking practice and statutory requirements, part of the earnings was required to be retained by the bank for the preservation of its status as an operating bank.

The "balance sheet" test adopted by the Court of Appeals for the Fourth Circuit gives no real effect to the provisions of Section 7507(b) that no tax shall be assessed, collected or paid which shall diminish the assets of the bank which are available for the payment of depositor claims and which are necessary for the full payment thereof, and construes the statute as establishing a purely mechanical test that whenever the accumulated earnings equal the sum of the unpaid depositor claims plus the proposed tax, the proposed tax may be assessed and collected without regard to whether such depositor claims may actually be lawfully paid or are, in fact, paid. This approach completely ignores the possibility that immediately following the year in which the accumulated earnings exceed the sum of the unpaid depositor claims and the asserted tax, the Bank may suffer a loss with the consequence that its assets would become insufficient to pay the depositor claims in full, and would be valid only if it is assumed that the Bank would be forthwith liquidated and there would be no diminution of assets in connection with such liquidation. Under this "balance sheet" test, not only are the determinations of the relevant banking authorities treated as being of no significance but, in fact, no qualitative judgment at all is required to be exercised.

The conflict between the Sixth and Eighth Circuits, on the one hand, and the Fourth Circuit, on the other hand, may be summarized as follows:

1. The Sixth and Eighth Circuits both construe the words "available for the payment of such depositor claims" and "necessary for the full repayment thereof" as meaning actually "available" and actually "necessary" under the particular facts and the laws and regulations applicable to banking institutions and both hold that in answering the

questions of what assets are "available" for payment and what assets are "necessary" to be retained to assure full payment, the determinations of the relevant banking authorities should be considered and given the same weight as other administrative decisions.

2. The Fourth Circuit construes the words "available for the payment of such depositor claims" as meaning available at some time in the future and the words "necessary for the full payment thereof" as meaning merely that the balance sheet must show that there are assets on hand which are carried at values in excess of the unpaid depositor claims, with the consequence that there is no need to make any further determinations as to whether immediate payment can be made and whether it is necessary to retain any other assets until such payment is made in order to assure full payment.

This conflict between Circuits has arisen in an area involving the construction of a Federal tax statute which may affect many banking institutions and which was enacted for the primary purpose of assisting depositors who have waived their claims against closed banks in exchange for claims against future earnings in order to enable such banks to reopen and thereby contributed to the public purpose of maintaining a solvent and active banking system.

It is a matter of common knowledge that there are many thousands of banks which failed during the early 1930's and which were reopened pursuant to agreements under which, in order to avoid a complete liquidation and winding up of the closed banks, the existing depositors released a part of their claims and accepted in lieu thereof a claim against future earnings or segregated assets. It is equally a matter of common knowledge that banks still continue

to fail and are enabled to reopen only by virtue of arrangements under which existing depositors are willing to waive a part of their claims against the failing bank. It is impossible to ascertain how many of such banks as have heretofore failed may still be making payments on waived depositor claims subject to limitations imposed by the banking authorities under their duty to supervise the operation of the reopened banks and which, therefore, may be directly affected by the existing conflict between the Fourth and Sixth Circuits and the potential conflict between the Fourth and Eighth Circuits. It is equally impossible to ascertain how many banks may fail in the future and have the possibility of their being reopened impaired by reason of the existence of these conflicts.

The primary purpose of Section 7507(b) of the Internal Revenue Code of 1954 and of the corresponding sections of prior law is to assist depositors who have relinquished their immediate claim to payment of a portion of their deposits in order to enable a bank in financial difficulties to reopen to recover such waived claims by providing that the Federal Government would not demand the payment of taxes which would reduce the assets which would otherwise be available and necessary for the payment of such claims. *Farmers & Merchants Bank v. Commissioner,* 175 F. 2d at 850; See also Reg. Sec. 301.7507-2(a), *supra* at p. 4). While this was the primary purpose, it is evident that the public purpose to be served was to encourage and facilitate the reopening of banks through assurance that in those cases where the depositors were looking to the bank's future earnings for the repayment of their waived claims, such earnings would not be diminished by claims for taxes. Since it is a matter of common knowledge that banks are a regulated industry and are only allowed to disburse so much of their earnings as are not required

under the regulatory statutes to be retained for their continued operation, it is reasonable to assume, as the Sixth and Eighth Circuits decided, that when Congress referred to "diminishing the assets thereof which are available for the payment of such depositor claims", it meant such assets as might otherwise be lawfully paid out on depositor claims. This public purpose of encouraging the reopening of banks would be seriously affected, if not frustrated, by the interpretation adopted by the Court of Appeals for the Fourth Circuit which clearly in fact extends the time required for the payment of the depositor claims and thereby reduces the inducements to the depositors to waive a part of their claims and enable the bank to reopen.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

OPINION OF UNITED STATES DISTRICT COURT

(Filed June 7, 1965)

This action was instituted by the Exchange and Savings Bank of Berlin, Maryland, for the recovery of $30,252.47 and interest thereon which the bank paid in income tax and assessed interest for the years 1957, 1958, 1959 and 1960.

The question at issue is whether the taxpayer bank qualifies during those years for exemption from taxation under Section 7507(b) of the Internal Revenue Code of 1964.[1]

The case comes to me on cross motions for summary judgment. There being no real contest as to the facts, they appear as hereinafter set out.

The plaintiff, the Exchange and Savings Bank of Berlin, Maryland, is a presently existing bank which was chartered in 1899 under the laws of Maryland. On February 11, 1932 the bank's affairs and assets were placed in the hands and under the control of the Bank Commissioner of Maryland by the bank's board. Shortly thereafter the Com-

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[1] 26 U.S.C. § 7507 (1958): Exemption of insolvent banks from tax.

(b) *Segregated assets; earnings.*—Whenever any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has been released or discharged from its liability to its depositors for any part of their claims against it, and such depositors have accepted, in lieu thereof, a lien upon subsequent earnings of such bank or trust company, or claims against assets segregated by such bank or trust company or against assets transferred from it to an individual or corporate trustee or agent, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank or trust company, such individual or corporate trustee or such agent, which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof. The term "agent", as used in this subsection, shall be deemed to include a corporation acting as a liquidating agent.

missioner was named receiver by decree of the Circuit Court for Worcester County, Maryland. On March 19, 1932 a depositors' agreement was entered into between the bank and its depositors[2] under the terms of which

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[2] "1. That the undersigned, depositors as aforesaid, do each and all hereby assign, transfer and set over unto the said THE EXCHANGE AND SAVINGS BANK OF BERLIN, MARYLAND, fifty percent (50%) of all deposits which are now held by said THE EXCHANGE AND SAVINGS BANK OF BERLIN, MARYLAND, for the account of each of the undersigned, but subject to the understanding, however, that such assignment and transfer of said percentage of said deposits is made for the purpose of creating a Reserve Fund for the protection of the solvency of said Bank and in order to at all times maintain such solvency, and said THE EXCHANGE AND SAVINGS BANK OF BERLIN, MARYLAND, is hereby authorized and empowered to use any part or all of said fund to replace any and all losses which it has in the past suffered or which it may in the future suffer, whether on account of losses in investments, depreciation in investments or the uncollectibility of any of its assets or otherwise, hereby releasing and discharging said THE EXCHANGE AND SAVINGS BANK OF BERLIN, MARYLAND, of and from all liability for the repayment of said Reserve Fund or any part thereof; but it is expressly understood by and between all the parties hereto that in the event that at any time in the future the financial condition of said Bank shall fully and unquestionably warrant the repayment of said Reserve Fund in whole or in part, then and in that event the Board of Directors of said THE EXCHANGE AND SAVINGS BANK OF BERLIN, MARYLAND, by and with the consent of the Bank Commissioner of the State of Maryland, shall repay said depositors ratably and proportionately all or any portion of said Reserve Fund; it is further expressly understood and agreed by and between all parties hereto that from and after the date on which said Bank is reopened interest on said Reserve Fund shall be set aside by said Bank at the rate of three per cent per annum but said interest shall not be paid or credited to the depositors creating such fund until the said fund is released in whole or in part by the authorization of the Board of Directors with the approval of the Bank Commissioner, at which time the accumulated interest shall be paid or credited thereon on such part or parts of the Reserve Fund as may be released or made subject to withdrawal.

"2. The said Reserve Fund shall be considered as a Contingent Fund for the prevention of an impairment of the capital stock of said Bank within the meaning of the Laws of Maryland relating to banking institutions, but, in the vent of a merger or future liquidation of said Bank, this fund shall be preferred over capital stock in the distribution

the depositors agreed to release the bank from claims for fifty percent of the deposits then held by the bank and the depositors thereby took in lieu of those claims a lien upon the future earnnigs of the bank. The balance of the released claims in 1932 was $258,736.03.

Fortunately, the bank survived, prospered, and began repaying depositors under the 1932 agreement. By 1957, the first year in question in this case, the balance due to depositors under the 1932 agreement was $91,878.59. A special reserve account for depositors, set up under the terms of the Depositors' Agreement, contained $79,038.88. In that year the bank requested permission of the Maryland Bank Commissioner to pay five percent of the unpaid balance of released deposits but the Commissioner, after consulting with the Federal Deposit Insurance Corporation of which the bank is a member, declined such permission and disallowed any payment. The Commissioner refused to allow the payments on the basis of his finding that any such payments would have jeopardized the safety of the bank's current depositors as well as the eventual full repayment of the unpaid claims of depositors under the 1932 agreement. The bank reported net income of $25,284.83 for 1957 and claimed immunity from tax liability under Section 7507(b). Immunity was disallowed and the bank was required to pay a $7,648.11 assessed tax deficiency plus $1,272.00 interest.

In 1958 the bank requested permission from the Bank Commissioner to pay ten percent of the unpaid balance of released deposits. This permission was granted, conditioned upon the bank improving the condition of its loan portfolio. Payment of $25,491.75 was made, leaving a balance due depositors of $66,386.84. The special reserve account for depositors contained $76,459.77. The bank reported net income of $22,487.60 and paid $6,741.60 in tax.

In 1959 the bank was again permitted to pay only ten percent of the unpaid balance of released deposits, based

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of the assets of said Bank, and no dividend shall be paid upon the capital stock until said Reserve Fund shall have been repaid or made subject to withdrawal in full."

upon the findings of the Commissioner, and payment of $25,535.45 was made, leaving a balance of $40,851.39 due depositors. The special reserve account for depositors contained $61,830.30. The bank reported net income of $24,056.49 and paid $7,216.95 in tax.

In 1960 the bank was permitted by the Bank Commissioner to pay another ten percent of the unpaid balance of released deposits and payment of $25,619.00 was made, leaving a balance due depositors of $15,232.39. The special reserve account for depositors contained $44,174.57. The bank reported net income of $24,827.04 and paid $7,373.81 in tax.

The remaining balance due the depositors was paid in 1961 and no refund claim has been filed for that year.

In summary the facts indicate that during the years 1957 through 1960 the bank was diligent in its efforts to pay the claims of the participants under the depositors' agreement of 1932 as rapidly as the Bank Commissioner would permit. In each of the years in question the Bank Commissioner permitted only those amounts as set out above to be paid to depositors on the basis that, in the Commissioner's opinion, the payment of larger sums would have jeopardized the safety of then current depositors as well as the eventual full repayment of the unpaid claims of depositors under the 1932 agreement. The Bank Commissioner stated that the payment of federal income taxes on earnings for the years 1957 through 1960 reduced by at least the amount of such taxes the payments which the bank would otherwise have been permitted by his office to make to depositors under the 1932 agreement. Under no circumstances would the Commissioner have permitted the bank to disturb or decrease its surplus as shown on its balance sheets for the years 1957 through 1960 in order to make payments on the account of the unpaid claims of depositors under the 1932 agreement. It seems significant that at no time from 1932 through 1960 were any dividends paid to stockholders of the bank.

It seems clear that the original depositors' agreement created an equitable lien on future earnings of the bank,

as required by Section 7507(b). See *Farmers & Merchants Bank v. Commissioner*, 175 F. 2d 846 (8th Cir. 1949). The second requirement of the statute that payment of taxes diminish the assets which "are available for the payment of (these claims) and necessary for the full payment thereof" presents a difficult question of statutory construction.

Both parties, in the briefs and arguments, have given a great deal of consideration to the nature of this statute and whether it is to be given a "strict," a "liberal" or merely a "fair" construction. With all deference to the numerous cited authorities favoring either "strict" or "liberal" constructions of this and related enactments, I shall follow the Court of Appeals of the Sixth Circuit in giving the statute a "fair construction." *Bank of Leipsic Co. v. United States*, 288 F. 2d 467, 470 (6th Cir. 1951). By this I simply mean that the statute should be construed to effectuate the Congress' purpose in enacting it.

Both parties acknowledge that the section was not designed to relieve the banks or their stockholders of their liability for taxes, but rather to protect depositors who have agreed to release their claims from competing claims of the United States for the payment of income taxes out of the bank's earnings. The government defines the question quite properly. Would the payment of taxes in any of the disputed years have diminished the assets which were available for the payment of the depositors claims and which were necessary for the full payment thereof? In pursuing its analysis, the government relies upon a very simple calculation. When the total surplus from all earnings sources at the end of any tax year exceeds the amount due to the depositors under the agreement, together with the amount of federal taxes otherwise due, the bank's immunity is terminated. According to the government, the financial condition of a bank as measured by banking practice and rules is not the proper criterion for determining when tax immunity should be terminated. On the other hand, the taxpayer relies upon the undisputed finding of the Bank Commissioner that payments to depositors in excess of those made would have jeopardized

not only the safety of current depositors but the possibility of eventual full repayment of the old depositors, the people the statute was designed to protect, and therefore argues that the payment of income taxes did diminish the assets available for repayment of the old depositors in each year.

On the record before me, the crucial issue is the relevance of the determination by the Maryland Bank Commissioner. The government has not disputed his determination nor has it presented an alternative analysis of the bank's financial condition which would allow the court to determine (if the court were prepared to substitute its financial judgment for that of the Commissioner) what interests the Commissioner was protecting in making his determination. In this situation, I must accept as fact the determination of the Commissioner that payments in excess of those made should not be permitted, certainly not payments totaling the entire indebtedness, and that, had payments in excess of the amount permitted been made, the interests of the old depositors in full and final repayment would have been endangered.

The authorities are divided upon the question of the relevance of these findings. The Internal Revenue Service has maintained its position, at least since 1941, that they are irrelevant. See G.C.M. 22656, Cum. Bull. 1941-1, 293. This holding was reaffirmed by the Service in Rev. Rul. 60-139, 1960-1 Cum. Bull. 677, and has received encouragement from the courts in two cases involving somewhat similar determinations, *De Kalb Trust & Savings Bank v. United States*, 253 F. 2d 53 (7th Cir. 1958) and *Clinton Trust Co. v. United States*, 52 F. Supp. 671 (Ct. Cl. 1943). The taxpayer relies upon the holding of the Sixth Circuit in *United States v. Bank of Leipsic Co.*, 272 F. 2d 341 (6th Cir. 1959), affirming 58-2 U.S.T.C. 9921 (N.D. Ohio 1958) a case virtually indistinguishable from the instant case on its facts. In my view the *Leipsic* opinions of the Sixth Circuit and of Judge Kloeb in the district court more nearly comport with the intention of Congress in passing these provisions and should be followed. I pass now to a consideration of these cases.

The Bank of Leipsic in the tax years 1952 through 1954 found itself in very much the same circumstances as did the Exchange & Savings Bank of Berlin some years later. It had entered into a depositor's agreement in the early 1930's which created the necessary lien on future earnings to bring it within the provisions of § 3798 of the Internal Revenue Code of 1939 (now § 7507 of the 1954 Code). In each of the tax years 1952-1954 the bank had a balance sheet surplus sufficient to pay the claims of the old depositors. However, as here, the state banking authorities in conjunction with a representative of the Federal Deposit Insurance Corporation had determined that only small percentages of the total claims should be paid in each year in order to avoid danger to the fiscal structure of the bank. Distinctions do exist, of course. In *Leipsic* the bank's board of directors which made the original requests of the banking authorities was controlled by the old depositors. This was not the case here. Also the paper balance itself demonstrated a far narrower surplus margin than is apparent in this case. However, the government has chosen not to examine the background of the Commissioner's decision here and rather than speculate in the absence of any qualitative summary of the bank's financial status, I will accept the Commissioner's findings. In each case the government took the straightforward position that the State authorities' findings were irrelevant and that the question of available surplus depended strictly upon an examination of the bank's balance sheet. Judge Kloeb, the District Court in the *Leipsic* case, noted a very valid criticism of the government's position:

> "I think its fault lies in the fact that it is measuring the depositors' claims substantially dollar for dollar with the amount of surplus on hand at any one time, and that just can't be done in banking circles; furthermore, that position does not appear to be contemplated by the statute. If you have an operative bank, you have to have a bank with ample capital, surplus and undivided profits as compared with its total resources to enable it to obtain and retain the confidence of the depositing public."

The Court of Appeals adopted this reasoning in its per curiam affirmance, 272 F. 2d 341, *supra*. In due course the Internal Revenue Service noted its nonacquiescence in Revenue Ruling 60-139 cited *supra*, stating its objection to the *Leipsic* decision as follows:

> "Under the court's decision, immunity would depend on the judgment of Federal or state bank authorities as to whether the surplus and undivided profits are sufficiently built up to permit payment of the depositor's claims."

However, a careful review of both the Court of Appeals and District Court opinions in *Leipsic* indicate that this particular criticism is invalid. In its opinion the Court of Appeals implied that the conclusions of the banking authorities could be re-examined where their conclusions were arbitrary or improper or where they had abused their discretion. Judge Kloeb in his opinion accepted an even greater duty to review the banking authorities' determinations. In *Leipsic* the board of the bank was controlled by the old depositors who in each of the years in question made demands for repayment which the banking authorities found the fiscal structure of the bank could not bear. Judge Kloeb reviewed all of the facts and concluded:

> "I think the whole situation indicates that primarily the efforts (of the banking authorities) were on behalf of the depositors, and secondarily on behalf of the bank."

This, taken with other statements in his opinion, I think indicates a proper willingness to review the bases of these decisions.

At this point it seems useful to review the facts of the instant case. In 1957 the bank requested permission to pay five percent of the unpaid balance of the released deposits. This request was denied. In 1958 and 1959 requests were made to repay ten percent of the unpaid balance. The surplus condition was markedly improved in each year. However, in 1958 the payment was allowed only upon the

condition that the bank improve its loan portfolio and it was not until 1959 that the bank's request was granted unconditionally. With these facts and their parallel to the *Leipsic* situation in mind, I think the fallacy in the government's balance sheet test is clear.

The government in arguing for its balance sheet analysis urged that, when the balance sheet surplus exceeds the amount of the old depositors' claims, the failure to end the bank's tax immunity can only accrue to the benefit of the bank. As the bank could, on paper at least, make the old depositors completely whole, it argues that the benefits of the tax immunity cannot thereafter accrue to the old depositors. Or, to put the question in the terms of the statute: how can the payment of the tax decrease the amount of surplus available for the payment of these claims? This analysis gains currency by its simplicity. However, by its use of the blessings of hindsight it virtually guts the statute of any power to aid a functioning bank in repaying these old debts. If we were to examine the records of any of the banks which became viable entities by grace of these reorganizations and were to telescope the tax years and reassess the respective benefit of tax immunity to the bank and to the old depositors, we would find that the entire benefit really accrued to the bank. I would imagine that in virtually all of these cases the fixed dollar claims of the old depositors were repaid eventually and the stockholders of the banks benefited by the exact amounts of the tax immunity. What Congress granted the old depositors was an immunity to the bank which was to be used by the bank to repay these obligations as rapidly as there was money available to repay it.

The Service argues that because the bank has the paper surplus to pay all obligations ipso facto all future benefit is to the stockholders and the bank. However, that view neglects the practicalities of the situation. The depositors can not get their money the minute that a surplus exists. The state banking authorities have the final say over that matter. In each of these three years they determined not only that there would be no total payment but that the payment of anything more than what was approved would

jeopardize the depositors' chances for eventual full repayment and further that imposition of the tax would reduce the amount of each yearly repayment installment by at least the amount of the tax imposed. If the Bank Commissioner acted in good faith and was motivated principally by his concern for the welfare of the depositors, I see no reason why the tax immunity should not be continued.

I will not look back in 1965 to these three years and calculate now who received the benefit of this extension of immunity. From what appears of the history of this bank, I am sure that the stockholders were the real beneficiaries of all immunity from the enactment of this statute. The depositors all had fixed dollar claims which have all been repaid. The immunity, translated into dollars and cents all accrued to the bank. However, the immunity throughout speeded the payment of these claims as it would have in these three years had it been allowed.

The government's analysis seems devoid of any meaningful relevance to Congress' intention to speed repayment. The first year in which there is a sufficient balance sheet surplus to allow repayment has no real significance in terms of the overall picture of financial progress for the institution upon which Congress surely realized eventual repayment of these favored depositors depended. I here find that delay in complete repayment was the result of the necessities of banking practice and was designed to effectuate the speediest and surest possible complete repayment of these old depositors and that therefore the taxpayer bank was within the immunity which Congress intended when it enacted § 7507(b).

There is nothing in the opinions in *De Kalb Trust & Savings Bank v. United States, supra,* or *Clinton Trust Co. v. United States, supra,* which dissuades me from this view. In *De Kalb,* the court found as a fact that there was no lien created by the depositors' agreement there to bring it within the terms of our statute and further that had taxes not been assessed and paid the monies would still not have been paid to the depositors. The facts now before me indicate clearly that a lien on future earnings existed

here and that the amounts paid in taxes by the bank would have been paid directly to the depositors in each of the three years 1957 to 1959.

The *Clinton Trust Co. case* is also distinguishable in that the percentage of the bank's earnings upon which the old depositors had a lien was so small that the court there concluded that the owners would be benefited temporarily more from the application of the statute than the depositors. In the instant case the temporary benefit is all to the depositors. Furthermore, there is nothing contained in the statements of the court in this case or in the *De Kalb* case with which I am not in substantial agreement. I will construe the statute as strictly as seems to comport with Congress' intention in enacting it and I agree that it was intended for the benefit of the depositors and not for the benefit of the bank.

The tax year 1960 presents a somewhat different problem, however, from any of the three years preceding it. If, as I have held, federal taxes were not properly assessable in the tax years 1957 through 1959, additional payments to the depositors, by the taxpayer's own admission, should have totaled the amount of the tax assessed and paid. The total figure for those three years is $22,878.66, a sum sufficient to repay substantially all of the bank's obligations to the old depositors in 1960 as well as the income tax upon the bank's earnings. It appears from these facts alone that the bank cannot prevail for the tax year 1960 regardless of the findings of the Bank Commissioner in that year. Any other decision would result in a windfall to the bank without having speeded the repayment of the old depositors. The government's motion for summary judgment as to the tax year 1960 must therefore be granted while its motions for the years 1957-1959 will be denied. Summary judgment for the plaintiff will be granted for those years.

THOMAS J. MICHIE,
United States District Judge.

June 4, 1965

JUDGMENT

The Court having considered the stipulation and the arguments of counsel, and having entered its findings of fact and conclusions of law herein, it is in conformity therewith:

ORDERED, that plaintiff have judgment against defendant for the principal amount of $22,930.10, with interest thereon according to law.

Done this 23 day of July, 1965.

/s/ THOMAS J. MICHIE,
United States District Judge.

UNITED STATES COURT OF APPEALS
For The Fourth Circuit

No. 10,398

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368 Fed. 2nd 334

The Exchange and Savings Bank of Berlin,
Appellee,

v.

United States of America,
Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND, AT BALTIMORE.
THOMAS J. MICHIE, District Judge.

(Argued June 1, 1966. Decided September 6, 1966.)

Before HAYNSWORTH, Chief Judge, J. SPENCER BELL, Circuit Judge, and HEMPHILL, District Judge.

J. SPENCER BELL, Circuit Judge:

The United States appeals from a summary judgment for the Plaintiff, The Exchange and Savings Bank of Berlin, Maryland, in an action brought by the bank to recover income taxes and interest for the years 1957, 1958 and 1959. The district court held that the bank qualified for exemption from taxation during the years in question under the provisions of section 7507(b) of the Internal Revenue Code of 1964.[1] We cannot agree.

On February 11, 1932, the bank's directors placed it in the hands of a receiver. On March 19, 1932, an agreement was entered into between the bank and its depositors under which the depositors assigned to the bank fifty per cent of their deposits[2] and received in return a lien on the bank's future earnings. By 1957 the balance due to the depositors under this agreement had been reduced to $91,878.59. The bank's statement as of the close of business on December 31, 1957, showed a special reserve account of $79,038.88 which had been set aside to meet its obligations to the depositors. During that year the bank's net earnings were $25,284.83 ($17,636.72 after taxes). Thus, the amount of the bank's earnings in the special fund, plus its current earnings after taxes, exceeded the amount which it needed

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[1] "26 U.S.C. § 7507 (1964): Exemption of insolvent banks from tax.

"(b) Segregated assets; earnings.—Whenever any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has been released or discharged from its liability to its depositors for any part of their claims against it, and such depositors have accepted, in lieu thereof, a lien upon subsequent earnings of such bank or trust company, or claims against assets segregated by such bank or trust company or against assets transferred from it to an individual or corporate trustee or agent, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank or trust company, such individual or corporate trustee of such agent, which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof. The term "agent", as used in this subsection, shall be deemed to include a corporation acting as a liquidating agent."

[2] The item amounted to $258,736.03.

to pay off the depositors' claims in full by $4,797.01. In addition to this sum, the bank statement carried a surplus of $65,000.00, of which all but approximately $13,000.00 was conceded to have been derived from earnings subsequent to 1932. It was also stipulated that the bank's statements represented a true and correct statement of the bank's financial condition. The situation in 1958 and 1959 continued to improve to the extent that the special fund itself, without more, was adequate to pay off the depositors in full. Indeed, the excess of surplus[3] over the amount needed to satisfy the old depositors plus income taxes was $95,818.97 for 1958 and $112,818.45 for 1959.

In 1957, the State Banking Commissioner, after consulting with the officials of the Federal Deposit Insurance Corporation, of which the bank is a member, declined the bank's request to permit it to make a payment of 5% of the unpaid balance to its old depositors on the ground that such a payment would have jeopardized the safety of the bank's current depositors as well as the eventual payment in full of the old depositors under the 1932 agreement. In 1958, the bank was permitted to make a payment of 10% or $25,491.75 upon condition that the bank improve the condition of its loan portfolio. The condition was met and the payment made. In 1959 and 1960 the bank was allowed to pay 10% each year. In 1961 the remaining balance was paid.

In essence, the statute in question provides that whenever a bank has entered into such an agreement as here existed, no tax shall be collected "which shall diminish the assets [of the bank] which are available for the payment of such depositor claims and which are necessary for the full payment thereof." The district court interpreted the words "available for payment" to mean available for immediate distribution under the orders of any banking authorities recognized by the taxpayer bank as controlling its operations. We think the test of "availability" intended by

[3] In 1958, this included the current earnings after taxes, the surplus of $70,000.00 and the special reserve of $76,459.77. In 1959, the surplus was $75,000.00 and the special reserve $61,830.30.

Congress was whether the assets were on hand without regard to whether the relevant banking authorities were willing to allow such assets to be paid out at that time. In this case the taxpayer's books furnished the best test of whether those assets were available since all parties are agreed that the statement did not understate the market value of the bank's assets and that at least by 1957 there were available sufficient funds to pay off the old depositors in full.

The district court judgment was based upon the per curiam opinion of the Sixth Circuit in *United States v. Bank of Leipsic Co.*, 272 F. 2d 341 (6 Cir. 1959), but we must respectfully disagree with the rationale of that opinion. We begin with the premise that section 7507(b), being an exemption provision, should be construed strictly against the taxpayer. *Helvering v. Northwest Steel Mills*, 311 U.S. 46, 49 (1940). We think it also apparent that the purpose of the statute was to benefit the old depositors as an inducement to them to refrain from demanding immediate liquidation of a bank which was in trouble and not to benefit the stockholders as such. In *Clinton Trust Co. v. United States*, 52 F. Supp. 671, 679-680 (1943), the Court of Claims summarized its purpose as follows:

> "The statute does not permanently forswear the collection of taxes for the benefit of depositors of an insolvent bank. It defers their collection to the extent to which the tax money goes to pay the depositors. The bank and its owners are not intended to gain or the Government to lose taxes as a result of the application of the statute. . . . The taxes are therefore collectible, and collectible immediately, out of any part of the earnings of the Bank which, if not paid out for taxes, would still not be paid to the depositors."

Legislative history does not support the conclusion that the word "available" as used in the statute was meant to be construed as currently available for distribution instead of meaning simply on hand. Indeed the "available" phraseology was not contained in the original version of

section 818(b) of the 1938 Act as drafted by the Senate Finance Committee and passed by the Senate. That version simply required that

> ". . . no tax shall be assessed or collected . . . which shall diminish the assets . . . necessary for the full payment of such depositor or other creditor claims."

When it was decided by the Congress to eliminate the provisions above relating to "other creditor claims" than those of depositors, the language of the bill was amended in conference to read as it does today. It was this committee which used the word "available," but it is apparent from the report that it was not dealing with the distinction between "on hand" and immediately available for payment to depositors under local administrative decision. The report[4] provides as follows:

> "(1) The provisions which prohibit assessment and collection of tax where the effect would be to diminish the assets available for the payment of creditors other than depositors have been eliminated. The result of this change is that in cases where the claims of creditors are junior to the claims of depositors, if depositors' claims would not be diminished by the payment of taxes, then the abatement of tax does not apply. If, however, creditors' and depositors' claims rank equally, taxes which would diminish the assets available for either would diminish the assets available for both, and in such cases taxes would be abated."

We think it clear from the above report that the word "available" was used in the statute to reach those cases where other creditors shared on equal rank with the depositors. Such is not the case here, where it is conceded that the old depositors hold claims superior to existing creditors of the bank. We think this history refutes the plaintiff's contention that the Congress's intention was to permit the statutory exemption to continue until the bank not only had on hand accumulated assets sufficient to pay

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[4] H. Conference Rep. No. 2330, 75 Cong., 3d Sess., pp. 55-56 (1939-1 Cum. Bull. (Part 2) 817, 835).

off its old depositors but also had built up a cushion of tax-free working surplus which would satisfy the various standards of local administrative authorities. When the funds are safely on hand the congressional objective has been accomplished and the bank should again operate on an equal basis with its competitors.

Reversed.

JUDGMENT

(Filed September 6, 1966)

United States Court of Appeals
For The Fourth Circuit

No. 10,398

The Exchange and Savings Bank of Berlin,
Appellee,

v.

United States of America,
Appellant.

Appeal from the United States District Court for the District of Maryland.

This cause came on to be heard on the record from the United States District Court for the District of Maryland, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the United States District Court for the District of Maryland, at Baltimore, with direction to enter judgment for the appellant (defendant below), in accordance with the opinion of the Court filed herein.

J. SPENCER BELL,
United States Circuit Judge.

APPENDIX B

United States District Court, Northern District of Ohio
Western Division, Civil Action No. 7871, 11/4/59

The Bank of Leipsic Company,

v.

United States of America.

Findings of Fact and Conclusion of Law

Findings of Fact

1. Certain of the facts were made the subject of a written stipulation which is incorporated herein in its entirety by this reference.

2. Plaintiff was incorporated on February 24, 1924, as an Ohio banking company, which transacted business as such until January 13, 1932, at which time plaintiff was forced to close, and under Ohio law then in effect (Section 710-89 OGC) the Superintendent of Banks of Ohio took over the custody and control of the property and business of the bank subject to the jurisdiction of the Court of Common Pleas of Putnam County, Ohio.

3. Plaintiff was reopened on October 11, 1932, under a plan of reorganization which was approved by the Superintendent of Banks of Ohio and by the Common Pleas Court of Putnam County, Ohio.

4. A substantial portion of the business of the plaintiff consisted of receiving deposits, and making loans and discounts.

5. Under the plan of reorganization the depositors entered into an agreement with the bank and its shareholders as follows:

Depositors Agreement

"In consideration of the reopening of The Bank of Leipsic Company, Leipsic, Ohio, and consent thereto being obtained from the Superintendent of Banks of the State of Ohio, and approval of the same being obtained from the Court of Common Pleas of Putnam County, Ohio, as provided in Section 710-89 of the General Code of Ohio, I, the undersigned depositor in The Bank of Leipsic Company, do hereby agree to waiver forty (40%) per cent of any and all deposits in said bank standing in my name and to accept payment of interest at the rate of four (4%) per cent, per annum, from the date of reopening of said bank, on the remaining sixty (60%) per cent of my said deposits.

"All securities and other assets which are ordered out of the assets of the bank by the State Banking Department are to be trusteed for the benefit of all depositors so waiving said forty (40%) per cent of their deposits, and the proceeds derived from the liquidation, and/or sale of said trusteed assets are to be paid from time to time to said depositors until such assets are entirely liquidated.

"It is understood that the stockholders, their heirs or assigns, of The Bank of Leipsic Company, shall not participate in dividends of any kind upon said stock until said depositors shall have been paid in full. And until said time, such Undivided profits as may not be required by law and by order of Superintendent of Banks, held for the benefit of said bank, may be credited in the Trustees' account in which said assets so taken out are placed, and shall inure to the benefit of said depositors so waiving said forty (40%) per cent of their said deposits.

"It is understood that all of the capital stock of said bank will be trusteed, but such trusteeing of said capital stock shall not be construed in any way as releasing the stockholders, their heirs or assigns, from their constitutional, statutory and individual liability.

The stockholders, their heirs or assigns, will also agree not to transfer any of their property for the purpose of escaping or evading payment of their said liability as such stockholders.

"It is further understood and agreed to by the undersigned that the remaining sixty (60%) per cent of my said deposit or deposits in said bank shall be released only in such amount and at such time as may be decided upon by a joint committee elected by the depositors and the Board of Directors of said bank, of which committee one-half (½) in number shall be selected by the depositors and one-half (½) in number by the Board of Directors.

"Witness my hand this day of 1932.

"Witness Signed

"Witness ."

6. The 40 per cent of the deposits on which plaintiff was released and discharged from liability amounted to the sum of $387,609.11.

7. Under said plan and in consideration of the bank's reopening the bank segregated and transferred a trustee certain assets which the Superintendent of Banks of Ohio required to be charged out on said reopening and which were used exclusively for the payment of the 40 per cent of deposits which had been waived. During the years in issue, the remaining segregated assets at December 31 of each such year, were as follows:

Assets	*Market or Fair Value*
at December 31, 1952	
Cash on Deposit in The Bank of Leipsic Company	$2,386.43
150 shares Reinsurance Corporation of New York	1,050.00
25 shares Electric Bond & Share	650.00
100 shares United Corporation	487.50
$2500 Wacker Wabash Bond	2,600.00
Total Segregated Assets	$7,173.93

at December 31, 1953	
Cash on Deposit in The Bank of Leipsic Company	$7,965.94
TOTAL SEGREGATED ASSETS	$7,965.94
at December 31, 1954	
Cash on Deposit in The Bank of Leipsic Company	$7,745.98
TOTAL SEGREGATED ASSETS	$7,745.98

The entire remaining balance of segregated assets in the amount of $7,012.76 was paid to the depositors by the Trustees in 1955.

8. The amount that was paid from time to time to the depositors out of the undivided profits of plaintiff was controlled at all times by the Superintendent of Banks of Ohio.

9. Pursuant to the plan of reorganization and as a part thereof, the capital stock of plaintiff was deposited with the trustee, to be held by the trustee, and no dividends were to be paid thereon, until the 40 per cent of waived deposits were paid in full.

10. As a result of litigation from 1934 to 1937, an agreement was entered into whereby the Depositors Committee was given the right to select five members of the nine-member Board of Directors of plaintiff. From the date of said agreement of settlement and continuously until said waived deposits were paid in full in the year 1955, the depositors selected a majority of the members of the Board of Directors and thereby were at all times in control of the affairs of said bank.

11. No dividends have been paid by the plaintiff to its stockholders since January 13, 1932.

12. The Superintendent of Banks of Ohio would permit distribution only of such amounts of undivided profits as were in excess of the amount required to be retained by law or in accord with sound banking practice for the protection of the bank's waived depositors, as well as the bank's regular depositors, and the Superintendent of Banks found that during the years in issue the plaintiff's ratio

of total capital to total assets was below the average ratio for the United States as well as for the State of Ohio. In addition, the risk assets of plaintiff were increasing during these years.

13. The plaintiff was diligent in its efforts to pay off the depositors' claims. Several of plaintiff's requests to make payments to the depositors were refused or reduced by the Superintendent of Banks of Ohio. There was an earnest and persistent desire upon the part of the bank to make payments to the depositors out of the earnings of the bank at a rate greater than the Superintendent of Banks of Ohio felt could be safely done and yet maintain a solvent bank. The Superintendent of Banks of Ohio was anxious to have the depositors' claims paid as soon as it could soundly be done and at no time were requests for payments refused by the Superintendent of Banks in order to continue or prolong the immunity from taxation.

14. The Revenue Agent's report for the calendar year 1952 did not result in any adjustments to the net income of the plaintiff as shown on its tax return as filed.

The Revenue Agent's report for the calendar year 1953 did not result in any adjustments to the net income of the plaintiff as shown on its tax return as filed.

The Revenue Agent's report for the calendar year 1954 did not result in any adjustments to the net income of the plaintiff as shown on its tax return as filed.

15. During the years 1932 through 1955 The Bank of Leipsic earned net profits and made payments to the depositors from its undivided profits and from its segregated assets as follows:

Year	Net Earnings	Payments from Undivided Profits	Payments from Segregated Assets	Unpaid Balance of Depositors Claims at 12/31
1932	$ 558.80	$ —	$ —	$387.609.11
1933	2,690.72	—	—	387,609.11
1934	2,358.17	—	—	387,609.11
1935	21,228.63	—	—	387,609.11
1936	22,457.51	—	—	387,609.11
1937	10,783.10	—	78,772.14	308,836.97
1938	8,868.18	2,000.00	17,302.79	289,534.18
1939	9,968.62	—	—	289,534.18
1940	8,620.79	—	—	289,534.18
1941	13,046.73	19,302.78	—	270,231.40
1942	2,306.60	—	—	270,231.40
1943	23,826.38	12,000.00	7,302.76	250,928.64
1944	24,078.49	16,540.20	2,762.59	231.625.85
1945	25,496.08	—	—	231,625.85
1946	28,949.54	13,000.00	6,923.72	211,702.13
1947	28,586.03	—	—	211,702.13
1948	25,220.83	19,246.45	—	192,455.68
1949	34,306.30	19,246.42	—	173,209.26
1950	39,118.68	19,245.93	—	153,963.33
1951	41,288.42	19,245.47	—	134,717.86
1952	45,304.07	38,485.05	—	96,232.81
1953	50,507.33	19,240.05	—	76,992.76
1954	41,847.09	38,480.00	—	38,512.76
1955	28,768.48	31,500.00	7,012.76	—

16. The Superintendent of Banks of Ohio in exercising his discretion as to the amounts that could be paid from undivided profits to the depositors from time to time, relied on the fact that the plaintiff had been immune and would continue to be immune from taxation until said claims were paid in full.

17. The assessment and payment of taxes in the calendar years 1952, 1953 and 1954 would have diminished the assets available and necessary for the payments of the depositors' claims and would have diminished by at least the amount of such taxes, the payments permitted by the Superintendent of Banks of Ohio to be made to the depositors by plaintiff in such years.

18. The depositors obtained a lien upon the earnings of the bank until such time as the waived deposits were paid in full.

19. The following amounts were paid by plaintiff on August 10, 1956, to the defendant for the calendar years 1952, 1953 and 1954, after receipt by plaintiff of the statutory notices of deficiency dated June 15, 1956:

(a). $22,449.68 of income and excess profits tax, plus interest of $4,585.89, or a total of $27,035.57 for the calendar year 1952.

(b). $23,164.45 of income and excess profits tax, plus interest of $3,342.03, or a total of $26,506.48 for the calendar year 1953.

(c). $9,900.14 of income tax, plus interest of $834.32, or a total of $10,734.46 for the calendar year 1954.

20. Plaintiff filed its income tax returns (Form 1120) for the calendar years 1952, 1953 and 1954 with the District Director of Internal Revenue at Toledo, Ohio, within the statutory period required for the filing of such returns.

21. No tax was paid by plaintiff upon the filing of its returns for the calendar years 1952, 1953 and 1954 and a statement of plaintiff's claim for immunity from taxation was attached to such returns pursuant to Section 3798(b) of the Internal Revenue Code of 1939 and Section 7507(b) of the Internal Revenue Code of 1954, and the Commissioner's regulations applicable thereto.

22. Statutory notices of deficiency were sent to plaintiff by register mail on June 15, 1956, notifying the plaintiff of proposed deficiencies for the calendar years 1952, 1953 and 1954 in the amounts listed in Paragraph 19 (a), (b) and (c) hereof, respectively.

23. The alleged deficiencies plus interest were paid by plaintiff to the District Director of Internal Revenue, Toledo, Ohio, on August 10, 1956.

24. On December 28, 1956, plaintiff filed with the District Director of Internal Revenue in Toledo, Ohio, claims

for refund of income and excess profits taxes and interest thereon for the calendar years 1952, 1953 and 1954, on the ground that plaintiff is entitled to an immunity from tax in the years 1952, 1953 and 1954 pursuant to Section 3798(b) of the Internal Revenue Code of 1939 and Section 7507(b) of the Internal Revenue Code of 1954. These claims for refund were filed within the statutory period permitting the filing of such claims.

25. A period of more than six months elapsed between the date plaintiff filed its claim for refund and the date the plaintiff filed its Complaint herein.

CONCLUSION OF LAW

A. The plaintiff was released from its liability to its depositors for 40 per cent of the depositors' claims and the depositors accepted, in lieu thereof, a lien upon the subsequent earnings of the plaintiff.

B. The assessment and collection of the disputed taxes would have reduced the payments to the former depositors in at least the amount of such taxes.

C. The assessment and collection of the taxes in the calendar years 1952, 1953 and 1954 would have diminished the assets of the plaintiff which were available and necessary for the payment of the depositors' claims.

D. Plaintiff was entitled to immunity from Federal income and excess profits taxes on its net income for the taxable years 1952, 1953 and 1954 and the assessment of such taxes for said years was illegal.

E. The plaintiff is entitled to recover on the First Cause of Action the sum of $27,035.57 and interest thereon, as provided by law, from the date of payment, to wit, August 10, 1956, together with costs; on the Second Cause of Action the sum of $26,506.48 and interest thereon, as provided by law, from the date of payment, to wit, August 10, 1956, together with costs; on the Third Cause of Action the sum of $10,734.46 and interest thereon, as provided by law, from

the date of payment, to wit, August 10, 1956, together with costs.

/s/ FRANK L. KLOEB,
United States District Judge.

ORAL OPINION BY JUDGE KLOEB

Gentlemen, I have had an opportunity to study this case twice, the first time last April when I made an attempt to have it tried, and again in the last two days. I think I am very familiar with the facts of the case and the exhibits that have been offered and received in evidence.

During the noon hour I studied the Stipulations that have been filed with the Court that were offered this morning together with the papers and exhibits that are a part thereof, and I have also had an opportunity to read and study very carefully the Illinois case, the DeKalb case, because it appears that the Government relies substantially upon that case.

We have a situation here where there is very little case law that we may turn to and be influenced by.

The Plaintiff relies upon the Nebraska case of the Eighth Circuit, and as I mentioned a moment ago the Government relies upon the DeKalb case which was decided in the Seventh Circuit.

We have here a situation where the plaintiff bank seeks to recover for income taxes assessed against and paid by it under protest for the years 1952, 1953 and 1954.

The taxes paid for the year 1952 amounted to approximately $27,000.00; for the year 1953, approximately $26,500.00 and for the year 1954, approximately $10,700.00. The total taxes paid under protest for those three years amounts to about $64,000.00 in round numbers.

The plaintiff bank closed its doors in January of 1932 along with many other banks in the country, and in Septem-

ber of 1932 it came before the Superintendent of Banks for the State of Ohio, — it being a state bank, — with a proposal whereby the depositors agreed to waive, and save the bank company from any liability whatever, 40 per cent of their deposits on the condition that they, the depositors, would have a lien upon the undivided profits of the bank, and in addition thereto would have a lien upon certain charged out assets of the bank which were and are inconsequential so far as we are now concerned.

An agreement was signed and presented to the Superintendent of Banks, and in October, 1932, with his consent the bank opened its doors subject to the depositors' agreement with the bank and with the consent of the Superintendent of Banks. I believe at the time that it opened its doors it had a capital of $50,000.00 and a surplus of $15,000.00, barely enough to permit it to deal fairly with the public. Evidently the Superintendent of Banks had enough confidence in the personnel of the bank to permit it to open its doors under those conditions.

I believe at a later date the stockholders collected amongst themselves some one and a half times the bank's capital, or $75,000.00, which they also put into the assets of the bank for the purpose of enabling it to operate.

The bank did open its doors and again operated, — and I think this is very important, — they not only began but they continued until 1955 to operate under the control of a board of directors consisting of nine members, five of those members having been selected by and placed upon the board by the depositors who had waived 40 percent through the Depositors' Committee, the other four members representing the stockholders of the bank. So that the control of the bank from 1932 to 1955 was in the hands of the Depositors' Committee.

The exhibits that have been attached to the Complaint as well as the Stipulations that have been entered into include correspondence had with the Superintendent of Banks by the plaintiff bank beginning in 1950 and ending in about 1956. That correspondence indicates an overwhelming desire upon the part of the bank, controlled by

the directors and the depositors, to allocate funds out of the earnings of the bank sufficient to pay these depositors at a rate greater than the Superintendent of Banks felt could be safely done and yet maintain a solvent bank. I find that they at times requested a ten percent payment and the Superintendent of Banks, acting in conjunction with the Regional Director of the FDIC, cut them down to five percent, and it appears from the capital and the surplus, the undivided profits and the assets of the bank that he was well justified in holding them down so that they did not in their zeal impair the solidity of the bank.

The plaintiff relies upon the case of Farmers and Merchants Bank of Ceresko, Nebraska, versus The Commissioner of Internal Revenue, 175 Federal Reporter 2d 846. I believe that case is substantially in point with the case that we are considering here today. One particular difference is that the depositors' agreement with the bank provides that they should be repaid only from dividends that had been declared on the stock of the stockholders; whereas in the case before us the agreement provides that the depositors shall be paid from the earnings, that is, the undivided profits of the bank.

The Court in that case in the Eighth Circuit, — and this was decided in 1949, — said this:

> "The question is whether the reorganization agreement gave rise to 'a lien upon subsequent earnings' of the reorganized bank, in favor of the former depositors, within the signification of that term in the exemption provisions of section 3798(b) of the Internal Revenue Code."

The Court then proceeds to argue and come to the conclusion that the depositors in that case had an equitable lien upon the assets of the bank because of the provision that they were to be paid out of declared dividends, and that seemed to be the complication in the case.

The agreement in that case provided, among other things:

> "(We) do hereby agree that out of the dividends declared upon our stock, the said 75 per cent so re-

linquished shall be paid to the depositors, before the stockhoders, so agreeing, receive any dividends upon their stock; said 75 per cent so relinquished is to be in no way a charge against the Farmers & Merchants Bank or a liability thereof, but it is to be repaid only from the dividends on the stock above described when said dividends are declared * * *"

On page 848 the Court makes this statement:

"Manifestly, the parties anticipated that the reorganized bank would be able to operate and make profits, or there could hardly have been any point in not allowing it to remain closed and be liquidated. Certainly, also, it was the intention in the making of the agreement that the relinquished deposit claims should be repaid, not as a matter of beneficence but of obligation, if the bank succeeded in making earnings from which this legally and soundly could be done. Any other interpretation would be unnatural and unreasonable."

On Page 850, Paragraph (6), we find this statement, — and that seems to be the bone of contention between counsel for the Government and the plaintiff:

"It may further be added that the purpose of section 3798(b) manifestly is one of beneficent policy toward the depositors of insolvent banks rather than one of exemptive favor to the banks themselves. Cf. Clinton Trust Co. v. United States, 52 F. Supp. 671, 679, 100 Ct. Cl. 348. This purpose may not be lightly ignored, in any construction or application of the section, as between the Commissioner's or a Collector's attempt to treat it as a mere technical exemption and the right of the depositors of a previously distressed bank, who have released the bank from liability; for part or all of their deposits and have accepted in lieu thereof a lien upon the bank's future earnings, to recoup the amount of their released claims."

Thereupon, the court reversed the decision of the Tax Court and remanded the cause to be tried, the Tax Court having held that the bank had no proper claim for refund of the taxes paid.

I might call attention to the particular section that is referred to that has been the bone of contention in this litigation, Section 3798(b) of the Internal Revenue Code of 1939. Deleting the inapplicable parts of the section:

> "Whenever any bank has been released or discharged from its liability to its depositors for any part of their claims against it and such depositors have accepted in lieu thereof a lien upon subsequent earnings of such bank or trust company, no tax shall be assessed or collected which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof."

It appears to be the contention of the Government that during the period from 1932 through 1954, both inclusive, there were total earnings of about $398,000.00, and there was paid in full to the depositors their claims for a total of $387,000.00, thereby leaving a surplus of about $11,451.00 over and above the sum that would be necessary to pay the depositors' 40 per cent waived claims in full.

Therefore, it is their position that they were entitled to levy this tax beginning in 1952. In fact, — reading from the brief of the Government, — which probably counsel have exchanged, at least they seem to be conversant with what was said in each other's brief, — it says this:

> "* * * the agent in his report of November 16, 1955, found that the balance sheet of December 31, 1952 indicated that the accumulated earnings since January 13, 1932, were then in excess of the outstanding depositors' claims against such earnings and that the collection of the income tax for 1952, 1953 and 1954 would not diminish the accumulated earnings to a point below the amount necessary to pay such claims in full."

That appears to be the position of the Government, and in order to illustrate its position it shows that as of December 31, 1952, there was a balance available for tax collection of $50,471.07; the amount necessary to pay depositors, $96,232.81; and income tax for 1952, $22,249.68, which would leave a balance when the tax was paid, or a surplus balance, of $28,021.39.

In the opinion of the Superintendent of Banks, whose judgment in the matter is at least on a consultative basis as provided in the agreement, the Superintendent of Banks in his judgment was of the opinion, apparently, that to slice the bread that thin would have resulted in a bank of such lean proportions surpluswise as to endanger its possibilities as a receiver of deposits from the general public.

The Defendant, the Government, relies upon the DeKalb case, found in 253 Federal Reporter 2d, at Page 53.

That was a case in which the bank brought action against the Government to collect a tax said to have been arbitrarily assessed against the bank for the year 1946. Judge Igoe, of the District Court at Chicago, Illinois, whom I have known favorably and well for the past 25 years, entered judgment adverse to the bank and the bank appealed.

It seems that in this case the depositors entered into an agreement whereby sixty per cent of the amount of deposits was transferred and assigned to the bank and each depositor waived all rights thereto and agreed to accept in lieu thereof deferred certificates issued by the bank for like amounts payable solely out of future profits of the bank, and the certificates expressly provided that no lien or preference of any kind existed against any of assets of the bank in favor of the holders of the certificates.

It also appeared that at the end of 1945 the bank had ample assets to pay off the claims of the holders of the certificates, and if the disputed income taxes assessed against the bank for 1946 had not been assessed and paid,

the amounts paid would not have gone to the holders of the certificates anyhow.

The Court said this on Page 55:

> "The contested issues are whether this statute was intended by Congress for the benefit of banks as well as depositors who had waived claims; whether these depositors were given a lien upon subsequent earnings of the taxpayer bank in lieu of their waived deposits, as required under the statute; and whether the assessment and collection of income taxes from taxpayer for 1946 diminished assets of the taxpayer bank available and necessary for payment of depositors' claims for waived deposits."

On Page 56:

> "Section 3798 requires that, for it to be operative, the depositors must have accepted, in lieu of their claims, 'a lien upon subsequent earnings of such bank * * *', as well as the requirement that the tax 'shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof.'
>
> "It should be noted that the depositor's certificate itself expressly provides: 'It is understood and agreed that no lien or preference of any kind exists against any of the assets of the bank in favor of the holder of this certificate * * *' ".

On the same page the Court gets into the question of whether or not the payment of the taxes would diminish the assets available and necessary for the payment of the depositors' claims.

It says this:

> "Furthermore, we fail to see the validity in taxpayer's contention that the collection of taxes for 1946 diminished the assets available and necessary (italics) for the full payment of the balance due on the cer-

tificates. At the end of 1945 taxpayer had ample assets to pay off these claims and so represented to the state, on January 29, 1946, in requesting permission for the payment. It stated that it had an undivided profits account of $111,660.98, and on December 31, 1945, its surplus was $119,179.31. Further, at the end of 1946, after payment to the former depositors, its surplus was $146,010.87. Thus, it appears conclusively that if the disputed taxes had not been assessed and paid they would not have gone to the former depositors."

I don't think we have that situation here. Therefore, I don't believe that the DeKalb case can be a guide to the Court in the determination of this matter except as to some points of law that the Court notes are general in their extent and application, such as the fact, as counsel contended, that Section 3798 is an exemption statute and must be strictly construed in favor of the Government.

I think the position of the Government here, acting through its agent who made this finding in 1952, and then again in 1953 and 1954, has taken a rather precarious position and one that the Court would not want to take and have its position used as a citation or criterion for future cases.

I think its fault lies in the fact that it is measuring the depositors' claims substantially dollar for dollar with the amount of surplus on hand at any one time, and that just can't be done in banking circles; furthermore, that position does not appear to be contemplated by the Statute. If you have an operative bank, you have to have a bank with ample capital, surplus and undivided profits as compared with its total resources to enable it to obtain and retain the confidence of the depositing public. That is the effort that the Superintendent of Banks was making here, because he realized that if he agreed to the demands of the depositors, through their majority representation on the board of directors, and paid the amounts that they were asking to be paid, that he might thereby endanger the position of the bank and as a result endanger

the ultimate success of the depositors in regaining their waived deposits.

I think the whole situation indicates that primarily the efforts were on behalf of the depositors, and secondarily on behalf of the bank.

Under the circumstances, the Court can follow but one course, and that is to sustain the prayer of the Complaint in this case, which reads as follows:

> "WHEREFORE, plaintiff demands judgment against defendant on the First Cause of Action in the principal amount of $27,035.57 and interest thereon, as provided by law, from the date of payment, to wit, August 10, 1956, together with costs; on the Second Cause of Action in the principal amount of $26,506.48 and interest thereon, as provided by law, from the date of payment, to wit, August 10, 1956, together with costs; and on the Third Cause of Action in the principal amount of $10,734.46 and interest thereon, as provided by law, from the date of payment, to wit, August 10, 1956, together with costs."

The plaintiff may prepare Findings of Fact and Conclusions of Law, drawn in accordance with this oral Opinion, and the Defendant may within ten days thereafter lodge with the Court its exceptions and suggested additions thereto.

OPINION OF COURT

United States of America,
Appellant,

v.

Bank of Leipsic Company,
Appellee.

No. 13802

United States Court of Appeals
Sixth Circuit

Dec. 2, 1959

Before MARTIN, CECIL and WEICK, Circuit Judges.

PER CURIAM.

This is an appeal from the judgment of the District Court awarding a refund to the appellee, The Bank of Leipsic Company, of income and excess profits taxes paid for the calendar years 1952, 1953 and 1954 in the total amount of $64,276.51.

The sole issue in the case is whether the bank was exempt from such taxes under the provisions of Section 3798(b) of the Internal Revenue Code of 1939, 26 U.S.C.A. § 3798(b), and Section 7507(b) of the Internal Revenue Code of 1954, 26 U.S.C.A. § 7507(b).

The Superintendent of Banks of Ohio closed the bank on January 13, 1932 and took custody and control of its property and business, subject to the jurisdiction of the Court of Common Pleas of Putnam County, Ohio.

On October 11, 1932 the bank was reopened under a plan of reorganization approved by the Superintendent of Banks and the Common Pleas Court. The plan provided that depositors of the bank waive 40% of their deposits amounting to $387,609.11.

The plan further provided for the protection and repayment to the depositors as follows:

> "All securities and other assets which are ordered out of the assets of the bank by the State Banking Department are to be trusteed for the benefit of all depositors so waiving said forty (40%) per cent of their deposits, and the proceeds derived from the liquidation, and/or sale of said trusteed assets are to be paid from time to time to said depositors until such assets are entirely liquidated.
>
> "It is understood that the stockholders, their heirs or assigns, of The Bank of Leipsic Company, shall not participate in dividends of any kind upon said stock until said depositors shall have been paid in full. And until said time, such Undivided Profits as may not be required by law and by order of Superintendent of Banks, held for the benefit of said bank, may be credited in the Trustees' account in which said assets so taken out are placed, and shall inure to the benefit of said depositors so waiving said forty (40%) per cent of their said deposits. It is understood that all of the capital stock of said bank will be trusteed, but such trusteeing of said capital stock shall not be construed in any way as releasing the stockholders, their heirs or assigns, from their constitutional, statutory and individual liability. The stockholders, their heirs and assigns, will also agree not to transfer any of their property for the purpose of escaping or evading payment of their said liability as such stockholders."

From time to time payments from undivided profits were made by the bank to the depositors, with the approval of the Superintendent of Banks and the Federal Deposit Insurance Corporation, and from segregated assets. The depositors were paid in full in 1955.

At various times the amounts which the bank wished to distribute to its depositors were reduced by the Superintendent of Banks. He took the position that to allow the larger payments would result in an impairment of the bank's financial structure.

It was the theory of the government that in 1952, 1953 and 1954, the bank had sufficient surplus to have paid its depositors in full and thereby terminated its tax exemption, and its failure to do so did not obviate its tax liability.

But, although on paper the bank appeared able to make the payments, it was in fact unable to do so. The Superintendent of Banks acting in conjunction with the representative of the Federal Deposit Insurance Corporation determined the amounts which could be safely paid by the bank to depositors. The Superintendent of Banks testified that it would have placed the bank in jeopardy of closing if he had permitted greater payments out of earning to depositors than those actually made.

The Internal Revenue Code of 1939 provides:

"§ 3798. Exemption of insolvent banks from tax.

* * * * * *

"(b) Whenever any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has been released or discharged from its liability to its depositors for any part of their claims against it, and such depositors have accepted, in lieu thereof, a lien upon subsequent earnings of such bank or trust company, or claims against assets segregated by such bank or trust company or against assets transferred from it to an individual or corporate trustee or agent, no tax shall be assessed or collected, or paid into the Treasury of the United States on account of such bank, or trust company, such individual or corporate trustee or such agent, which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof. * * *" 26 U.S.C. 1952 Ed., Section 3798.

Section 7507 of the Internal Revneue Code of 1954 is substantially the same.

The District Court found and the Government here concedes that under the plan the depositors had a lien on the

assets of the reopened bank which is the first requirement of the statute.

The only remaining question is whether the tax would diminish assets available and necessary for the full payment of the depositors.

R. W. Wortman, Secretary of the bank, testified that if the bank had been required to pay federal income and excess profits taxes for the taxable years in question, no payments could have been made to depositors.

The Superintendent of Banks and the Supervisory Examiner of the Federal Deposit Insurance Corporation testified that the assessment and payment of the taxes in said years would have, at least, reduced the payment to depositors in the amount of the taxes.

The District Court found as a fact that the payments to depositors would have been reduced by the amount of such taxes.

It was not proved or even claimed that either the Superintendent of Banks or the representatives of the Federal Deposit Insurance Corporation acted arbitrarily, improperly or abused their discretion in limiting the payments to depositors to amounts which in their judgment would preserve the financial integrity of the bank.

The findings of fact adopted by the District Judge are abundantly supported by the evidence. In our judgment, they bring the case clearly within the statutory exemption.

Chief Judge Kloeb, in an oral opinion, relied on the case of Farmers & Merchants Bank, Ceresco, Nebraska v. Commissioner, 8 Cir., 1949, 175 F. 2d 846, which supports his conclusion. He distinguished the case of DeKalb Trust & Savings Bank v. United States, 7 Cir., 1958, 253 F. 2d 53, relied upon by the Government, principally on the ground that the depositors in that case had no lien upon the assets of the reopened bank which is one of the requirements of the statute.

In the Farmers & Merchants Bank case, supra, the Court said (175 F. 2d at page 850):

> "It may further be added that the purpose of section 3798(b) manifestly is one of beneficent policy toward the depositors of insolvent banks rather than one of exemptive favor to the banks themselves. Cf. Clinton Trust Co. v. United States, 52 F. Supp. 671, 679, 100 Ct. Cl. 348. This purpose may not be lightly ignored, in any construction or application of the section, as between the Commissioner's or a Collector's attempt to treat it as a mere technical exemption and the right of the depositors of a previously distressed bank, who have released the bank from liability for part or all of their deposits and have accepted in lieu thereof a lien upon the bank's future earnings, to recoup the amount of their released claims."

The judgment of the District Court is, therefore, affirmed.